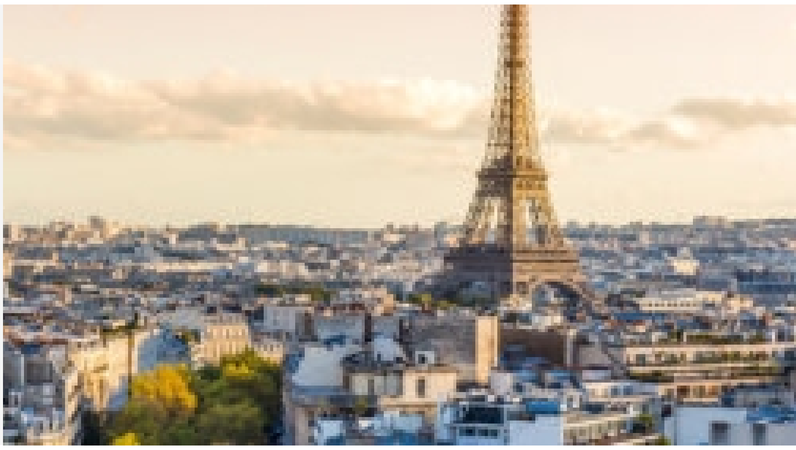
WATSON FARLEY & WILLIAMS

NEW FRENCH TAX RULES FOR 2018

1 JANUARY 2018 ● ARTICLE



THE FRENCH PARLIAMENT ADOPTED NEW IMPORTANT TAX MEASURES REGARDING CORPORATE AND INDIVIDUAL INCOME TAX IN TWO FINANCE BILLS DATED 29 DECEMBER 2017.

CORPORATE TAX

Reduction in the standard corporate income tax ("CIT") rate

The Finance Bill for 2018 progressively reduces the standard CIT rates from 33.1/3% to 25%. The new 25% rate will apply to all companies as of 1 January 2022.

The timetable is as follows:

- From January 2018, the new 28% rate will apply to all companies on the first €500,000 of taxable income earned over a 12 month period. Taxable income exceeding €500,000 will still be subject to the 33.1/3% rate;
- From January 2019, the new 28% rate will apply to all companies on the first €500,000 of taxable income earned over a 12 month period. Taxable income exceeding €500,000 will be subject to the new standard rate of 31%;
- From January 2020, the 28% rate will apply to all companies' taxable income;
- From January 2021, the 5% rate will apply to all companies subject to French CIT; and
- From January 2022, the 25% rate will apply to all companies subject to French

The current reduced CIT rate of 15% will still apply to small and medium-sized enterprises ("SMEs") for taxable income of up to €38,120 per annum.

New tax rules for restructuring operations

- The favourable merger tax regime set out in Articles 210A to 210C of the French Tax Code was previously subject to a tax ruling procedure before the French Tax Authorities when the restructuring operations involved a foreign

The Court of Justice of the European Union ruled that this tax ruling was contrary to the right to freedom of establishment in a decision on 8 March 2017 (CJEU, No. C-14/16, judgment of the Court, *Euro Park Service v Minister of Finance and Public Accounts*).

In order to comply with European Union ("EU") law, the Amended Finance Bill for 2017 abolishes said tax ruling procedure for cross-border restructuring operations as of 1 January 2018.

A new specific tax return will now have to be completed and foreign companies will have to declare a French permanent establishment, including any French assets/liabilities transferred to its profit;

- The new law also provides for an anti-abuse clause deriving from the EU Merger Directive denying the favourable merger tax regime to operations driven by tax evasion or avoidance considerations;
- The Amended Finance Bill for 2017 also creates a new procedure in order to obtain a prior confirmation from French Tax Authorities that the envisaged cross- border restructuring operation does not fall within the scope of French anti-abuse rules;
- The scope of restructuring operations eligible for the favourable merger tax regime has also been A contribution of shares reinforcing an existing controlling situation will now be assimilated to a contribution of a complete and autonomous branch of activity eligible to the favourable merger tax regime; and
- An old rule providing for a three year shareholding period, which was applicable at the level of a company contributing a complete and autonomous branch of activity under the favourable merger tax regime, has been The contributing company is no longer required to keep the shares received in exchange for a three year period.

Non-deductibility of taxes levied abroad pursuant to the provisions of double tax treaties

As a general rule, the Amended Finance Bill for 2017 provides for the non- deductibility in France of taxes levied abroad in accordance with the provisions of bilateral tax treaties concluded with France.

Consequently, a French company in a loss making position or with no sufficient taxable result is not entitled to offset the amount of taxes levied abroad against future corporate tax and will lose the benefit of this tax credit.

This rule does not apply to foreign taxes levied in a country which has not entered into a double tax treaty with France. Surprisingly, this new rule seems to be more favourable to French companies receiving income from a non-treaty jurisdiction.

Changes in the "Carrez rule"

Introduced in 2011, the Carrez rule limits the deductibility of interest expenses relating to the acquisition by a French company of a controlling stake in another company. Under this rule, the deduction of related financing costs is not allowed for an eight year period if the decisions and the control related to the acquired company are not managed at the level of the French acquiring company.

The Finance Bill for 2018 provides for a change in this anti-abuse rule by allowing the acquiring company to prove that decision or control is managed by a company established in a Member State of the EU or EEA that has concluded with France a double tax treaty including a clause against tax fraud and evasion.

This new rule applies to corporation tax due for the FY ending on 31 December 2017.

Changes to the CICE

The tax credit for competitiveness and employment ("CICE") is a tax benefit based on a percentage of a company's payroll (excluding wages exceeding two-and-a-half times the French minimum wage – SMIC), and can be directly offset against the CIT.

The Finance Bill for 2018 reduces the rate of the CICE from 7% to 6% from January 2018 and provides for its replacement by a reduction in social security contributions from 2019.

Company Added Value Tax ("CVAE" – *Contribution sur la Valeur Ajoutée des Entreprises*)

The CVAE is a local tax based on a company's added value. The tax rate for companies whose turnover ranges from €500,000 to €50m is assessed according to a sliding scale which ranges from 0% to 1.5%.

For companies which are members of a French tax consolidated group within the meaning of Article 223 A and seq. of the French tax code, the law formerly provided that the applicable tax rate had to be calculated with reference to the global turnover of the members of the fiscal unity. This provision was invalidated by the French Constitutional Court on 19 May 2017, which ruled that it created an unjustified difference of treatment between those companies which are members of a tax group and those which are not.

The Finance Bill for 2018 provides that the global turnover of companies has to be retained if companies meet the conditions for joining a tax group, whether or not said companies are actually member of a tax group.

This new rule will start applying to CVAE 2018 paid in 2019.

Removal of the 3% distribution tax

The validity of the 3% distribution tax which was applicable to dividend distributed by French companies has been considered by the European Court of Justice as contrary to EU law. The Finance Bill for 2018 eliminates the distribution 3% tax for dividend payments made on or after 1 January 2018.

Archaeology Tax for offshore projects

The *Redevance d'Archéologie Préventive,* ("Preventive Archaeology Tax") is payable by any person planning development work that affects the subsoil and is subject to notification and authorisation under the Town Planning Code or the Environmental Code, based on certain thresholds according to the nature of the project.

The Amended Finance Bill for 2017 adapts the Preventive Archaeology Tax for offshore development works (e.g. offshore windfarms).

In particular, it provides for a specific taxable basis and tax modalities for developments beyond one nautical mile from the territorial waters baseline or in contiguous areas as from 1 January 2018.

INDIVIDUAL INCOME TAX

Introduction of a 30% Flat-Tax on financial income

Until 1 January 2018, financial income such as dividends, interest, and capital gains on the sale of shares earned by individuals was subject to French annual income tax at progressive rates (up to 45%), exceptional contribution on high income (up to 4%), and to social contributions (15.5% in 2017).

The Finance Bill for 2018 changes this regime and introduces a 30% flat tax ("Flat- Tax") on financial income (interest, dividends, capital gains, carried interest, distributions and similar revenues), composed of a 12.8% income tax, and 17.2% social contributions, further to the 1.7% increase in the CSG rate provided for in the Social Security Finance Bill for 2018. The contribution on high income (up to 4%) however remains in place in addition to the 30% Flat-Tax which could result in a global marginal tax rate of 34%.

This new regime comes into effect on 1 January 2018.

Taxpayers are, however, allowed to opt for the former regime (i.e. application of the progressive income tax rates instead of the Flat-Tax). If so, the option is applicable to all their income subject to the Flat-Tax.

The Flat-Tax applies notably to:

- Interest and dividends;
- Capital gains from the sale of shares;
- Life insurance contracts;
- Free shares; and
- French BSPCE.

New pay-as-you-earn tax system for all French tax from 2019

The Finance Bill for 2018 introduces a new pay-as-you-earn tax system for individual income tax from 2019. French tax residents currently pay income tax a year in arrears, i.e. in the year following the year in which the income is received.

The main goal of this new measure is to avoid discrepancies between the year in which the income was earned and the year of its taxation. This new system will also align France with other countries such as the USA, UK and Germany.

Scope of the pay-as-you-earn tax system

Income subject to this new pay-as-you-earn tax system comprises wages, pension payments and unemployment benefits paid by French entities. Wages paid by non- French legal employers through a payroll outside France are excluded from the new regime.

Business revenue, self-employment revenue, rental and employment income paid by a non-French employer will be subject to monthly or quarterly income tax payments.

The tax payment mechanism for passive income (interest, dividends and capital gains) will remain unchanged.

Determining the pay-as-you-earn tax rate

Two methods are planned to calculate the tax rate:

The tax authorities will calculate the individual's tax rate based on the previous year's annual tax returns. However, the taxpayer can keep a standard tax rate if:

- The tax authorities cannot calculate an employee's individual tax rate; or
- An employee wants to keep their household tax rate

The pay-as-you-earn tax rate will vary from 0% to 45%.

Implementation process

This new pay-as-you-earn tax system will be implemented progressively:

- In 2018, taxpayers will pay individual income tax calculated on their 2017 income; and
- In 2019, taxpayers will pay tax on their 2019 income and will declare their 2018 In order to avoid double taxation, each taxpayer will benefit from a special tax credit called "CIMR" ("Tax Credit for Modernisation of Income Tax Collection") which should result in a lack of taxation on 2018 income under very strict conditions. In order to avoid tax optimisation, the exceptional income generated in 2018 should not benefit from the special tax credit and should remain taxable.

This should be confirmed at the end of the year in the next Finance Bill for 2019.

Free shares for managers and employees: new amendments

A free shares mechanism is frequently implemented not only in start-ups but also in multinational groups as an incentive plan for managers and employees.

The "Macron Law" adopted on 6 August 2015 has already improved the tax treatment applicable to free shares for employees and employers.

As a result of the introduction of the new 30% Flat Tax, the Finance Bill for 2018 amends the tax rules applicable to free shares granted as from 1 January 2018 as follows:

Acquisition gain

The Finance Bill for 2018 provides that a portion of the "acquisition gain" (i.e. the value of the shares on the date of their acquisition by the employee) which does not exceed €300,000 benefits from a global deduction of 50% for the calculation of individual income tax at the progressive rate and remains subject to social contributions of 17.2%, further to the 1.7% increase in the CSG rate included in the Social Security Finance Bill for 2018.

The portion of the acquisition gain exceeding this threshold is still treated as a salary.

The Finance Bill for 2018 also provides for a reduction of the employers' social contribution rate from 30% to 20%.

Capital gain

The capital gains resulting from the sale of the free shares also benefits from the new 30% Flat Tax.

French wealth tax ("ISF") replaced by French real estate wealth tax ("IFI") Until 1 January 2018, French ISF was assessed on all assets owned by a taxpayer when its net wealth exceeded a certain threshold (€1.3m). The basis for wealth tax included, subject to certain exemptions, worldwide assets for taxpayers domiciled in France and French assets for non-resident taxpayers.

The Finance Bill for 2018 eliminates the ISF and creates a specific real estate wealth tax called "IFI" (French "*Impôt sur la Fortune Immobilière*") which is assessed only on any real estate owned, directly or indirectly, by the taxpayer if the value of the taxpayer's real estate net assets exceeds €1.3m from 1 January 2018. All other assets (especially financial assets) are no longer subject to the French wealth tax. The aim of this reform is to encourage taxpayers to invest in the national economy.

Real estate assets or rights are excluded from IFI under the following very strict conditions and criteria:

- Real estate assets used, directly or through a company, for professional purposes;
- Real estate assets used by a company for its operating activity; and
- Shares representing less than 10% of a company under specific

The five year exemption for property held outside France for new French residents will still apply.

The Finance Bill for 2018 also provides for limitations of deductible debts from IFI:

- When taxable wealth exceeds €5m and debts represent 60% of this value, the portion of the debts exceeding this threshold is only deductible up to 50%;
- "Bullet loans" are no longer fully deductible: the value of the deductible debt is decreased each year by a portion deemed to have been repaid under an amortizable loan;

- Debts directly or indirectly granted from related parties or granted to buy an asset from related parties are no longer deductible, subject to certain

The IFI has the same threshold and tax rates as the former wealth tax. The tax shield mechanism limiting the amount of wealth tax depending on the total income of the taxpayers also remains applicable. The IFI has a large scope which requires a careful review for French and non-French tax residents directly or indirectly owning real estate in France.

KEY CONTACTS

ROMAIN GIRTANNER
PARTNER • PARIS

T: +33 1 76 40 15 68

rgirtanner@wfw.com

GILLES CERVONI
SENIOR CONSULTANT • PARIS

T: +33 1 76 40 15 81

gcervoni@wfw.com

HÉLÈNE IBOS
COUNSEL • PARIS

T: +33 1 76 40 16 20

hibos@wfw.com

MARIE-CHARLOTTE DE CASALTA
SENIOR ASSOCIATE • PARIS

T: +33 1 76 40 16 43

mdecasalta@wfw.com